Docket: 2007-2883(IT)G

BETWEEN:

MICHAEL OUNPUU,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on January 26-27, 2009, at Toronto, Ontario

Before: The Honourable Justice Wyman W. Webb

Appearances:

Counsel for the Appellant:	Russell D. Laishley
Counsel for the Respondent:	Justin Kutyan

JUDGMENT

The appeal from the reassessment made under the *Income Tax Act* ("*Act*") for the 1998 taxation year is allowed with costs, and the matter is referred back to the Minister of National Revenue for reconsideration and reassessment on the basis that the provisions of subsection 110.6(6) of the *Act* do not apply in relation to the claim for a capital gains deduction in computing the taxable income of the Appellant for 1998 and the Appellant is entitled to claim, in computing his taxable income for 1998, a deduction of $155,443 pursuant to subsection 110.6(2.1) of the *Act.*

Signed at Toronto, Ontario, this 26th day of February 2009.

"Wyman W. Webb"

Webb, J.

Citation: 2009TCC121
Date: 20090226
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BETWEEN:

MICHAEL OUNPUU,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR JUDGMENT

Webb, J.

[1] The issue in this appeal is whether the capital gains deduction, to which the Appellant would otherwise be entitled, should be denied pursuant to subsection 110.6(6) of the *Income Tax Act* (the "*Act*").

[2] The Appellant is a metallurgist. He has a Bachelor of Science degree in geological engineering. His expertise is in separating minerals from each other.

[3] In 1995, the Appellant worked at Lakefield Research, which was a testing facility owned by Falconbridge. At that time Falconbridge decided to concentrate its efforts on its nickel mining business and to sell Lakefield Research. The Appellant was a minor participant in a management buyout of Lakefield Research as part of which he acquired 40,000 shares of Lakefield Research Limited. In addition to these shares the Appellant also acquired an additional 2,434 shares when another shareholder left Lakefield Research Limited.

[4] In 1998, Lakefield Research Limited was proposing to expand its operations outside of Canada. The senior managers of Lakefield Research Limited were concerned that the shares of the company would cease to be qualified small business

corporation shares as defined in section 110.6 of the *Act*. Eric Steinmiller, a Chartered Accountant, submitted a proposed plan initially to the senior managers and then to all of the other shareholders (including the Appellant) to allow the shareholders to crystallize their capital gains deduction. There were approximately 12 shareholders of the company at that time. Each shareholder formed their own company and transferred their shares of Lakefield Research Limited to their own holding company.

[5] The Appellant transferred his shares to his holding company (a numbered Ontario company) in two separate transactions. He transferred 40,000 Class B common shares of Lakefield Research Limited to his holding company for 94 common shares of his holding company. No election was made pursuant to subsection 85(1) of the *Act* in relation to this transfer of shares. The second transaction was the transfer, to his holding company, of the 2,434 Class B common shares that the Appellant had acquired from a departing shareholder (and which he had held for less than two years as of that time). An election was made pursuant to subsection 85(1) of the *Act* in relation to this second transaction.

[6] It is the first transaction (the transfer of 40,000 Class B common shares to his holding company) that is relevant in this appeal. The parties agree that the capital gain arising as a result of this transfer of shares was $207,257 and the taxable capital gain was $155,443 (since taxable capital gains were 75% of capital gains in 1998). The issue is whether the Appellant is entitled to a capital gains deduction of $155,443 pursuant to section 110.6 of the *Act*. The Respondent does not dispute that if the Appellant would have filed his tax return for 1998 by April 30, 2000 and would have reported the capital gain in this return, then the Appellant would be entitled to this deduction.

[7] In this case, the Appellant did not file his tax return for 1998 until 2001 and he did not report any capital gains in this return when it was filed. An assessment of the Appellant's tax liability for 1998 was issued based on his tax return as filed but a subsequent reassessment of the Appellant's tax liability for 1998 was issued based on an inclusion of a taxable capital gain of $155,443 in his income (with no amount being allowed as a capital gains deduction).

[8] The Appellant's explanation for his failure to file his 1998 tax return on time and to report the capital gain was that he was busy at work and he did not fully understand the transactions that were completed in 1998 nor did he understand how to report these transactions on his tax return.

[9] Subsection 110.6(6) of the *Act* in 1998 provided as follows:

> (6) Notwithstanding subsections (2) and (2.1), where an individual has a capital gain for a taxation year from the disposition of a capital property and knowingly or under circumstances amounting to gross negligence
>
> (a) fails to file a return of the individual's income for the year within one year after the day on or before which the individual is required to file a return of the individual's income for the year pursuant to section 150, or
>
> (b) fails to report the capital gain in the individual's return of income for the year required to be filed pursuant to section 150,
>
> no amount may be deducted under this section in respect of the capital gain in computing the individual's taxable income for that or any subsequent taxation year and the burden of establishing the facts justifying the denial of such an amount under this section is on the Minister.

[10] When subsection 110.6(6) was added to the *Act* in 1985, the capital gains deduction was available for any capital gain arising as a result of any disposition of any capital property. As a result, many individuals could potentially benefit from a capital gains deduction. With the elimination of the capital gains deduction for any capital gain arising from the disposition of any capital property in 1994, only capital gains arising from the dispositions of qualified small business corporation shares and qualified farm property (and now qualified fishing property) are eligible for a capital gains deduction and hence the pool of individuals who could utilize their capital gains deduction has been reduced significantly.

[11] Subsection 150(1) of the *Act* in 1998 stated, in part, as follows:

> 150 (1) A return of income for each taxation year in the case of a corporation (other than a corporation that was a registered charity throughout the year) and **<u>in the case of an individual, for each taxation year</u>** for which tax is payable by the individual or **<u>in which the individual has a taxable capital gain or has disposed of a capital property</u>**, shall, without notice or demand therefor, be filed with the Minister in prescribed form and containing prescribed information,
>
> …
>
> (d) in the case of any other person, on or before
>
> (i) the following April 30…
>
> (emphasis added)

[12] The Appellant did not carry on any business in 1998. Since the Appellant disposed of capital property in 1998, his tax return for 1998 was required to be filed by April 30, 1999.

[13] Since the Appellant failed to file his 1998 tax return by April 30, 2000 and also failed to report the capital gain in this return when it was filed, subsection 110.6(6) of the *Act* will apply to the Appellant if:

1. The Appellant knowingly failed to file his 1998 tax return by April 30, 2000;

2. The Appellant, under circumstances amounting to gross negligence, failed to file his 1998 tax return by April 30, 2000;

3. The Appellant knowingly failed to report in his 1998 tax return the capital gain arising as a result of the transfer of 40,000 Class B common shares of Lakefield Research Limited to his holding company; or

4. The Appellant, under circumstances amounting to gross negligence, failed to report in his 1998 tax return the capital gain arising as a result of the transfer of 40,000 Class B common shares of Lakefield Research Limited to his holding company.

[14] If any one of these four situations applies to the Appellant then the provisions of subsection 110.6(6) of the *Act* will apply and the Appellant will not be entitled to claim his capital gains deduction in relation to the capital gain arising as a result of the disposition of these shares of Lakefield Research Limited to his holding company.

Knowingly Failed to File

[15] It was the position of counsel for the Respondent that to establish that the Appellant knowingly failed to file his tax return, the Respondent simply had to establish that the Appellant knew that his tax return for 1998 had not been filed by April 30, 2000. It seems obvious to me that the Appellant knew in 1999 and in 2000 that his tax return for 1998 was not being filed and therefore the Appellant knew that his tax return for 1998 was not filed on or before April 30, 2000. However the issue is whether this is sufficient to support the application of subsection 110.6 (6) of the *Act.*

[16] In *R.* v. *Sault Ste. Marie* [1978] 2 SCR 1299, the Supreme Court of Canada recognized three categories of offences. Justice Dickson stated as follows:

> I conclude, for the reasons which I have sought to express, that there are compelling grounds for the recognition of three categories of offences rather than the traditional two:
>
> 1. Offences in which mens rea, consisting of some positive state of mind such as intent, knowledge, or recklessness, must be proved by the prosecution either as an inference from the nature of the act committed, or by additional evidence.
>
> 2. Offences in which there is no necessity for the prosecution to prove the existence of mens rea; the doing of the prohibited act prima facie imports the offence, leaving it open to the accused to avoid liability by proving that he took all reasonable care. This involves consideration of what a reasonable man would have done in the circumstances. The defence will be available if the accused reasonably believed in a mistaken set of facts which, if true, would render the act or omission innocent, or if he took all reasonable steps to avoid the particular event. These offences may properly be called offences of strict liability. Mr. Justice Estey so referred to them in Hickey's case.
>
> 3. Offences of absolute liability where it is not open to the accused to exculpate himself by showing that he was free of fault.
>
> Offences which are criminal in the true sense fall in the first category. Public welfare offences would prima facie be in the second category. They are not subject to the presumption of full mens rea. <u>**An offence of this type would fall in the first category only if such words as**</u> "wilfully," "with intent," <u>**"knowingly,"**</u> or "intentionally" <u>**are contained in the statutory provision creating the offence.**</u> On the other hand, the principle that punishment should in general not be inflicted on those without fault applies. Offences of absolute liability would be those in respect of which the Legislature had made it clear that guilt would follow proof merely of the proscribed act. The overall regulatory pattern adopted by the Legislature, the subject matter of the legislation, the importance of the penalty, and the precision of the language used will be primary considerations in determining whether the offence falls into the third category.
>
> (emphasis added)

[17] In *Pillar Oilfield Projects Ltd.* v. *The Queen* [1993] G.S.T.C. 49, 2 G.T.C. 1005 Justice Bowman (as he then was), after quoting the above passage from *Sault Ste. Marie*, stated as follows:

> 11 Although Mr. Justice Dickson was dealing with "offences" I can see no reason in principle for not extending his analysis to administratively imposed penalties as well. A penalty, as the name implies, is a form of punishment.

[18] This analysis was adopted by Justice Rip (as he then was) in *Ross* v. *The Queen*, [1996] G.S.T.C. 33 4 G.T.C. 3099, at paragraph 24.

[19] In this particular case, the denial of a capital gains deduction is not described as a penalty in subsection 110.6(6) of the *Act*. However, the consequences of denying the capital gains deduction can be severe. In this case, if the Appellant is not allowed to claim the capital gains deduction, his income will increase by $155,443. Since his salary for 1998 was approximately $87,000, his additional liability under the *Act* (not including interest) arising from the denial of the capital gains deduction would be in excess of $45,000 (and the Appellant would also have an additional liability for Ontario provincial income taxes). It seems to me that a liability of this magnitude must be a penalty.

[20] As well the language that is used in 110.6(6) of the *Act* to describe the circumstances that will result in the application of that subsection (knowingly or under circumstances amounting to gross negligence) is the same language used in subsection 163(2) of the *Act* (knowingly or under circumstances amounting to gross negligence). Since subsection 163(2) of the *Act* is clearly a penal provision (*Udell* v. *The Minister of National Revenue* [1969] C.T.C. 704, 70 DTC 6019, at paragraph 46), it seems to me that the provisions of 110.6(6) of the *Act* should also be treated as a penal provision.

[21] As a result, in my opinion, the comments of Justice Dickson in *Sault Ste. Marie* are equally applicable to the provisions of subsection 110.6(6) of the *Act*. Since this section contains the word “knowingly”, the Crown must prove “some positive state of mind such as intent, knowledge, or recklessness”.

[22] The Supreme Court of Canada in *The Queen v. Canada Trustco Mortgage Company*, 2005 SCC 54, 2005 DTC 5523 (Eng.), [2005] 5 C.T.C. 215, 340 N.R. 1, 259 D.L.R. (4th) 193, [2005] 2 S.C.R. 601, stated that:

> 10 It has been long established as a matter of statutory interpretation that "the words of an Act are to be read in their entire context and in their grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act, and the intention of Parliament": see *65302 British Columbia Ltd. v. R.*, [1999] 3 S.C.R. 804 (S.C.C.), at para. 50. The interpretation of a statutory provision must be made according to a textual, contextual and purposive analysis to find a meaning that is harmonious with the Act as a whole. When the words of a provision are precise and unequivocal, the ordinary meaning of the words play a dominant role in the interpretive process. On the other hand, where the words can support more than one reasonable meaning, the ordinary meaning of the words plays a lesser role. The relative effects of ordinary meaning, context and purpose on the interpretive process may vary, but in all cases the court must seek to read the provisions of an Act as a harmonious whole.

[23] Subsection 110.6(6) of the *Act* refers to an individual who "knowingly" fails to file his or her tax return. If simply the knowledge that a tax return was not being filed is sufficient for the purposes of this subsection, then an individual who is careless or negligent in not filing his or her tax return but who knows that the tax return is not being filed, will be subject to the application of this subsection. It does not seem to me that Parliament would have intended to deny an individual his or her capital gains deduction simply because that person negligently or carelessly failed to file their tax return even if that person knew that the return was not being filed. Subsection 110.6(6) of the *Act* applies if an individual "knowingly or under circumstances amounting to gross negligence fails to file the individual's return" within the specified time, not if the individual carelessly or negligently fails to file his or her tax return within the specified time.

[24] Simply the knowledge that the return is not being filed is not, in my opinion sufficient for the application of subsection 110.6(6) of the *Act.* In my opinion, in order to establish that an individual **knowingly** failed to file his or her tax return, it is necessary to show that an individual intentionally (which will include an individual who is wilfully blind) failed to file his or her tax return in circumstances in which the individual was attempting to deceive to attain an economic advantage. An individual might "intentionally" not file his or her return at a particular time because that person intends to file it later but because the person is careless or negligent, the return is not filed within the specified time. In my opinion this type of intention is not what is required for this subsection to apply but rather an intention to deceive in order to realize an economic gain. The decisions of this Court that refer to deceit and economic gain in the context of subsection 110.6(6) of the *Act* are discussed below in relation to the failure to report a capital gain. If deceit to realize an economic gain is required to establish that a person knowingly failed to report a capital gain, then it

must also be required to establish that a person knowingly failed to file his or her tax return.

[25] Support for the position that simply knowing that a tax return is not being filed is not sufficient for the purposes of subsection 110.6(6) of the *Act* can be found in *Ragobar* v. *The Queen* [1995] 1 C.T.C. 2364. In that case the taxpayer did not file his tax return within the time period referred to in subsection 110.6 (6) of the *Act*. The explanation provided by the individual taxpayer was described in paragraph 21 of that case as follows:

> 21 The appellant explained his failure to file on time as follows. With respect to his employment income the deductions made by his employer at source sufficiently covered the taxes on that income and therefore he naively thought no return was necessary. As to the capital gain on the sale of 32 Askin he again naively thought that one need not report such gains until one had exhausted the capital gains deduction limit. Of course the Act obliges taxpayers to file returns on time. The question in the present case, however, is did the appellant "knowingly or under circumstances amounting to gross negligence" fail to file his return and declare the capital gain in time?

[26] It seems clear that the individual in that case would have known that the return was not being filed as the explanation provided was that he believed he had a valid excuse for not filing it. In that case Justice O'Connor held that subsection 110.6(6) of the *Act* did not apply. He stated in paragraph 25 that:

> 25 The Court accepts the appellant's explanation of why he failed to file on time and finds that he did not act knowingly or under circumstances amounting to gross negligence.

[27] Since the explanation was accepted and subsection 110.6(6) of the *Act* was not applied, simply knowing that a tax return is not being filed is not sufficient. By accepting his excuse, it seems to me that the finding was based on an interpretation of "knowingly" that would require an intention to deceive to realize an economic gain.

[28] In this case, the Appellant's only sources of income were employment income and some small amounts of investment income. Each year the Appellant would make the maximum RRSP contribution and he would receive a refund when his return was filed. This was the same in 1998 when, without taking into account the capital gain arising as a result of the disposition of the shares of Lakefield Research Limited, the Appellant was entitled to a refund of $1,147.

[29] Since the Appellant was entitled to a refund for 1998, there was no incentive for the Appellant to delay the filing of his 1998 tax return. The information that had been provided to the Appellant when the crystallization plan was proposed was that the Appellant's tax liability would not be affected by the crystallization transactions (and hence his refund would not change). The only property that the Appellant held in 1998 or in any subsequent year that would qualify for the capital gains deduction (assuming that the shares of Lakefield Research Limited ceased to be qualified small business corporation shares as anticipated by the senior managers) were the shares of Lakefield Research Limited that he held prior to the transfer of these shares to his holding company. The Appellant did not have anything to gain economically by filing his return late and I find that the Appellant did not knowingly fail to file his tax return within the specified period of time for the purposes of subsection 110.6(6) of the *Act.*

<u>Gross Negligence – Failure to File</u>

[30] The next issue is whether the Appellant, under circumstances amounting to gross negligence, failed to file his tax return for 1998 by April 30, 2000. Justice Strayer of the Federal Court Trial Division, in *Venne* v. *The Queen*, [1984] C.T.C. 223, 84 D.T.C. 6247, made the following comments on the meaning of gross negligence for the purposes of penalties imposed under subsection 163(2) of the *Income Tax Act:*

> "Gross negligence" must be taken to involve greater neglect than simply a failure to use reasonable care. It must involve a high degree of negligence tantamount to intentional acting, an indifference as to whether the law is complied with or not.

[31] In *Maltais* v. *The Queen* [1991] 2 C.T.C. 2651, 91 DTC 1385, Justice Bowman (as he then was) in dealing with a penalty imposed pursuant to subsection 163(1) of the *Act* stated as follows:

> 7. …Mr. Ghan on behalf of the respondent contended that subsection 163(1) in the form which is applied to 1989 did not require that there be a wilful intention to evade tax. In support of this position he pointed to the wording of the former 163(1) which referred to "Every person who wilfully attempts to evade the payment of tax payable by him" **<u>and to the wording of subsection 163(2) which uses the expression "knowingly or under circumstances amounting to gross negligence". These provisions require a mens rea of intent or of recklessness.</u>**
>
> (emphasis added)

[32] While the comments of Justice Bowman in relation to subsection 163(2) of the *Act* were *obiter* in that case, these comments were adopted by Justice Hamlyn in *Dunleavy* v. *The Queen* [1993] 1 C.T.C. 2648, 93 DTC 417.

[33] In *Boileau* v. *The Minister of National Revenue*, [1989] 2 C.T.C. 2001, 89 DTC 247, Justice Lamarre Proulx stated that

> 20. …It is true that by virtue of subsection 163(2), there is no accused nor is there a criminal charge. It would thus appear that it is not, as such, a criminal proceeding and that it remains a civil proceeding. However, **<u>the application of that subsection requires the evidence of mens rea or culpable conduct</u>**
>
> (emphasis added)

[34] It seems to me that in order for the Respondent to establish that the Appellant, under circumstances amounting to gross negligence, failed to file his 1998 tax return by April 30, 2000, the Respondent would have to show some culpable conduct on the part of the Appellant. In this case, it seems to me that the Appellant did not have any intent to deceive or mislead. He simply had the mistaken understanding that, as long as he was receiving a refund, that there was no particular time period within which he had to file a tax return and that any delay was costing him money as he would not receive his refund until his tax return was filed. Therefore, as a result, I find it that the Appellant did not, under circumstances amounting to gross negligence, fail to file his 1998 tax return by April 30, 2000.

Knowingly Failed to Report the Capital Gain

[35] The Appellant also did not report the capital gain in his tax return for 1998 when he finally filed this return. The next issue is whether the Appellant knowingly failed to report this capital gain. For the reasons stated above, in order for the Respondent to establish that the Appellant knowingly failed to report the capital gain, the Respondent would have to establish that the Appellant intentionally failed (or was wilfully blind in his failure) to report this capital gain to deceive the Canada Revenue Agency in order to attain some economic advantage.

[36] The Appellant was part of a group of shareholders who participated in the crystallization transactions. The accountant who designed the plan would attend group meetings of the shareholders and explain the proposed plan to the shareholders. The Appellant stated that these explanations were simply over his head. He did not retain the accountant to prepare his tax return.

[37] At the time that the transactions were being proposed, the accountant sent correspondence to the Appellant. In a letter dated January 27, 1998 the accountant stated that:

> You will sell your shares to Holdco, report the capital gain (being the excess of the value of the shares over your cost) that arises thereon on your tax return and claim the capital gains exemption to shelter the capital gain from income tax.

[38] There was also a letter from the accountant dated February 12, 1998 to the Appellant confirming that the capital gain that would arise on the transfer of the shares will be sheltered by the Appellant's capital gains deduction and the Appellant would not have an alternative minimum tax liability.

[39] A copy of the fax dated February 13, 1998 that was obtained from the files of the accountant was also introduced into evidence. This fax included the letter dated February 12, 1998 and two additional schedules that the Appellant was not able to locate among his files. These schedules show excerpts from two tax returns - one in which the capital gain and capital gains deduction amounts are claimed and one in which no capital gain is reported. In both cases, the amount of the income tax payable is exactly the same - $24,437.04.

[40] The Appellant stated that when he filed his tax return for 1998 he knew that something should be reported in relation to the crystallization transaction but he did not know how to report it. He indicated that he was mainly concerned with the bottom line. He wanted to ensure that the amount of taxes that was owing was accurately stated. It was his understanding that no taxes would arise as a result of the 1998 crystallization transaction.

[41] In my opinion, the Respondent has failed to show that the Appellant had knowingly failed to report the capital gain in his 1998 tax return for the purposes of subsection 110.6(6) of the *Act.* There was no indication that the Appellant had any intention of deceiving the Canada Revenue Agency. The Appellant had no reason to not report the capital gain as he had no other opportunity to utilize his capital gains deduction (which in 1998 was only available for qualified shares of a small business corporation or qualified farm property).

<u>Gross Negligence – Failure to Report the Capital Gain</u>

[42] As noted above, there is also an element of *mens rea* required for gross negligence. In *Colangelo Estate* v. *The Queen* [1998] 2 C.T.C. 2823, 98 DTC 1607,

Justice Bowie, in finding that subsection 110.6(6) of the *Act* did not apply in the circumstances of that case, stated as follows:

> 11 It is trite, of course, that ignorance of a penal law does not excuse the breach of it. The mental element is directed to the doing of the act; it does not require knowledge of the law that is breached. Although the provisions in issue here are penal in their nature, I am not persuaded that Parliament intended them to apply in such a way that a person who fails to report a gain because of ignorance of the requirement in the Act to do so must in every case suffer the penal consequences. Counsel for the Appellants does not contest that liability for the tax cannot be avoided by pleading ignorance of the law, and the taxpayers have, consistent with this submission, paid the tax, and interest on it, although not until after they began these appeals and, for the first time, got competent legal advice. The consequences of failure to report a capital gain found in subsection 110.6(6) are written in absolute terms, and are potentially very severe indeed. If it were intended that they apply to someone in the position of these Appellants, I would have thought that Parliament would have provided for the exercise of some discretion where there was no intention to evade tax, but merely ignorance of its incidence. The purpose of the provision, after all, is to discourage larcenous evasion, not to require that unsophisticated individuals become familiar with the provisions of a statute whose bulk and complexity are notoriously intimidating to many lawyers.

[43] Justice Hershfield in *Sidhu* v. *The Queen*, [2004] 2 C.T.C. 3167, 2004 DTC 2540 held that subsection 110.6(6) of the *Act* did apply in the circumstances of that case. He made the following comments on subsection 110.6(6) of the *Act:*

> 23 The Appellant relies on the decision in Venne v. R. (1984), 84 D.T.C. 6247 (Fed. T.D.) and argues that the bar for finding gross negligence has been raised to require a finding of a high degree of negligence tantamount to intentional acting. While some support may be found to argue otherwise, the decision in Venne does not raise the bar to require the Minister to establish actual intent to deceive or willful misconduct. If that were the test, the subject provision of the Act need only have referred to "knowingly" failing to report a gain. Actions "tantamount" to intentional actions are actions from which an imputed intention can be found such as actions demonstrating "an indifference as to whether the law is complied with or not".* The non-reporting of the gain in the circumstances of this case is a gross self-serving indifference to compliance. Not to mention such a significant gain to one's accountant upon whom you rely to ensure appropriate shelter for employment income from property and business losses, on the facts of this case which have shown the Appellant to be untrustworthy, is as tantamount to intentional acting as I might imagine. The burden here is not to prove, beyond a reasonable doubt, mens rea to evade taxes. The burden is to prove on a balance of probability such an indifference to appropriate and reasonable diligence in a self-assessing system as belies or offends common sense. Beyond this, I note that the evidence in this case

> that suggests an attempted cover-up of the Appellant's initial non-reporting only enhances the Respondent's position.

[44] Justice Hershfield did not refer specifically to whether there was any economic gain that the taxpayer could realize in that case by not reporting the capital gain. However in paragraph 9 of that case, Justice Hershfield referred to a “gain of some $160,000”. Since the property in that case was a rental property, a gain of this amount would exceed any available capital gains deduction that the taxpayer may have had available to him. The economic gain would be the avoidance of the tax liability on the portion of the taxable capital gain that would be in excess of the capital gains deduction available to the taxpayer pursuant to section 110.6 of the *Act* in 1993 (which was the year in which the taxpayer disposed of the rental property).

[45] In the present case, the Appellant did not attempt to cover up his failure to report the capital gain and in fact, the Appellant retained an accountant in 2004 to rectify any filing errors that he may have made. His accountant tried to make a voluntary disclosure of the failure to file in early 2004, but this voluntary disclosure was rejected by the Canada Revenue Agency.

[46] In *Carlson* v. *The Queen*, [1998] 2 C.T.C. 2476, 98 D.T.C. 1373, Justice Hamlyn stated as follows in finding that the provisions of subsection 110.6(6) of the *Act* did not apply in that case:

> 33 I found the Appellant to be a straight-forward, credible witness who mistakenly thought he did not have to report the share gain disposition because he concluded, from the advice he received from his associates in the other company, that the capital gain would be exempt from tax and did not have to be reported.
>
> 34 It is clear, the Appellant did not understand the whole basis and the need to report that is fundamental to the self-reporting tax system that applies to taxpayers in this country. And while he did his own return, beyond the advice that he did receive, he did not seek the assistance of the Revenue Canada Tax Guide as to how the gain should have been dealt with. But I did conclude he did receive some advice, albeit not good, or not fully complete.
>
> 35 Notwithstanding this finding, **I conclude from the evidence he was not attempting to deceive Revenue Canada. His mistaken belief was an honest held belief, and from that point of view, there was no economic consequence for him to hide the gain.** Albeit, this also was a mistaken view because from Revenue Canada's point of view he still had available the enhanced capital gain deduction. This economic gain would only be if the Appellant attempted to use this unused enhanced capital gain deduction in a future disposition. But from his evidence, and

> my assessment of the Appellant, this was not, nor is it now - from what I conclude from his evidence - his intent.
>
> 36 The amount of the omission is large, that is true. The failure to report is an indicia of negligence, I agree with that, but I cannot conclude that the action of the Appellant was to be a point of indifference as to whether the law was complied with or not. He believed he was complying with the law.
>
> (emphasis added)

[47] Justice Hamlyn refers to an attempt to deceive and a lack of economic consequences. In this case, I find that the Appellant was not attempting to deceive the Canada Revenue Agency and he had no economic gain since he did not own any other qualifying property.

[48] Justice Lamarre Proulx also refers to an economic interest as being an important element in relation to subsection 110.6(6) of the *Act* in *Estate of Paul Lévesque* v. *The Queen* 96 DTC 3250 when she stated that:

> 11 In analyzing this issue, I must say that this lack of knowledge of the Act is surprising and raises doubt. However, the evidence did not reveal any tax interest on the taxpayer's part in hiding this disposition of his shares to his son from the Minister. It therefore seems to me in these circumstances that it must be accepted that the taxpayer acted in the manner in which he did out of ignorance of this fiction of the Act whereby, at the time of a gift of a property to one's son, there is a deemed disposition of that property at its fair market value and that the proceeds of that disposition must be included in computing the taxpayer's income.
>
> 12 Ignorance or failure to obtain adequate information could in certain circumstances be a sufficient element to constitute gross negligence, particularly in cases where there is an economic interest in remaining ignorant. **<u>Here, the element that tilts the scales in favour of accepting the taxpayer's position is that there was no economic interest in this omission or in this failure to obtain adequate information.</u>**
>
> (emphasis added)

[49] In *Foisy* v. *The Queen* [2001] 1 C.T.C. 2606, 2000 DTC 2225, Justice Lamarre Proulx dealt with a case where an accountant (who was both a CA and a CMA and who had previously correctly reported capital gains), failed to report a capital gain of approximately $185,410. The issue in that case was whether the provisions of subsection 110.6(6) of the *Act* should apply to deny the capital gains deduction because the taxpayer had failed to report the capital gain in his tax return.

[50] Justice Lamarre Proulx made the following comments in *Foisy:*

25 As we have just read, the penalty for failing to report a capital gain is a harsh one. Not only is the exemption for the unreported capital gain lost and the taxable portion of the capital gain for the year in question required to be included in the individual's income, but an exemption to which the individual is supposed to be entitled throughout his or her life is lost forever. **In my view, in the context of section 110.6, it is necessary that the words "knowingly or under circumstances amounting to gross negligence" mean more than an intention not to report the capital gain. If the exemption provided for in subsection 110.6(2) of the Act did not exist, proving such an intention would be sufficient for a finding of gross negligence, since the purpose of not reporting would be to evade taxes. However, in the specific case where an exemption is granted for a capital gain, the failure to report the gain must occur in circumstances in which there is an intention to evade taxes, a malicious intent not to comply with the Act's requirements or an intention to deceive the Minister.**

…

30 The Minister's officer said that one reason for the decision to apply subsections 110.6(6) and 163(2) of the Act was that the appellant knew he had to report capital gains since he had already reported some. I have trouble seeing a connection between that fact and the existence of malicious intent to deceive the Minister. Rather, I see it as evidence that the appellant acted properly with regard to the Act, as was argued by his counsel.

31 **To satisfy me that there was malicious intent or gross negligence on the part of the appellant, it would have been necessary to show me how it was in the appellant's interest to hide the capital gain or prove to me that his behaviour was habitually negligent or wrongful. For example, if I had been shown that the appellant was about to pass the $500,000 exemption limit or that purchasing qualified small business corporation shares was a common occurrence for him, I could have seen that the appellant had a culpable interest in hiding information from the Minister. (On the contrary, the evidence showed that the appellant had purchased shares in public corporations, not qualified small business corporation shares, with the proceeds of disposition of the shares that gave rise to the capital gain.) If it had been proved to me that the appellant usually tried to deceive the Minister in his tax returns, I could have seen in the taxpayer's conduct a malicious intent to deceive.**

32 It is my view that the evidence has not shown that, when he committed the wrongful act of not reporting the capital gain, the appellant intended to deceive the Minister or evade some liability to pay tax, or that there were circumstances amounting to gross negligence. The appellant was negligent to some extent but, in view of the reasons for which and the circumstances in which it occurred, that

> negligence is not serious enough for subsection 110.6(6) of the Act to apply. Consequently, subsection 163(2) of the Act does not apply either.
>
> (emphasis added)

[51] In this case as well, there was evidence that the Appellant had previously correctly reported capital gains and had, in one year, previously reported the capital gains deduction. However, the 1998 transaction was different from the previous transactions. In the previous transactions the Appellant had sold shares for cash but in the 1998 transaction he sold shares of Lakefield Research Limited for shares of his own holding company. When the initial letters were being written, the fair market value of the shares of Lakefield Research Limited had not been determined. If a previous correct reporting of capital gains was not sufficient to support the application of section 110.6(6) of the *Act* to an accountant, then in my opinion it should not support the application 110.6(6) of the *Act* to a metallurgist.

[52] There was no evidence in this case that the Appellant had any intention of deceiving the Minister or evading taxes or any malicious intent not to comply with the *Act*. The Appellant had nothing to gain by not reporting the capital gain. In order for the Appellant to have failed to report the capital gain under circumstances amounting to gross negligence his conduct would have had to have been tantamount to an intentional failure to report the capital gain in an attempt to deceive the Canada Revenue Agency in order to realize an economic gain.

[53] Therefore since there was no evidence of such culpable conduct on the part of the Appellant, in the present case, he did not fail to report the capital gain arising from the disposition of the shares of Lakefield Research Limited in his 1998 tax return under circumstances amounting to gross negligence.

[54] As a result, the appeal is allowed with costs, and the matter is referred back to the Minister of National Revenue for reconsideration and reassessment on the basis that the provisions of subsection 110.6(6) of the *Act* do not apply in relation to the claim for a capital gains deduction in computing the taxable income of the Appellant for 1998 and the Appellant is entitled to claim, in computing his taxable income for 1998, a deduction of $155,443 pursuant to subsection 110.6(2.1) of the *Act*.

Signed at Toronto, Ontario, this 26th day of February 2009.

“Wyman W. Webb”

Webb, J.

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